

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 ROME 004651

SIPDIS

PARIS FOR USOECD  
FRANKFURT FOR WALLAR

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [IT](#) [EUN](#)

SUBJECT: ITALYS G7 FINANCIAL SHERPA CRITICIZES EU STUDY  
ON ECONOMIC GROWTH

1. SUMMARY: A HIGH-LEVEL STUDY GROUPS RECOMMENDATIONS FOR STIMULATING GROWTH IN EUROPE RECEIVED MUCH CRITICISM IN ROME, ESPECIALLY FROM LORENZO BINI SMAGHI, ITALYS G7 FINANCIAL SHERPA. IN JULY 2002, THE EUROPEAN COMMISSION PRESIDENT ESTABLISHED THIS GROUP TO EXPLORE STRATEGIES FOR ECONOMIC GROWTH IN EUROPE. ANDRE SAPIR, AFFILIATED WITH THE FREE UNIVERSITY OF BRUSSELS, A MEMBER OF THE COMMISSIONS GROUP OF POLICY ADVISORS AND CHAIR OF THE STUDY GROUP, AND FELLOW GROUP MEMBERS RECENTLY CAME TO ROME TO DISCUSS THEIR JUST-PUBLISHED REPORT, AN AGENDA FOR GROWING EUROPE. END SUMMARY.

2. ON SEPTEMBER 25, ISAE - ISTITUTO DI STUDI ED ANALISI ECONOMICA - A SEMI-GOVERNMENTAL ITALIAN RESEARCH INSTITUTE, HOSTED A ROUNDTABLE TO PRESENT AN AGENDA FOR GROWING EUROPE. IN HIS REMARKS, SAPIR UNDERScoreD THAT THE EUS TOP PRIORITY MUST BE ECONOMIC GROWTH. WITHOUT GROWTH, HE STATED, EUROPE'S SOCIAL MODEL CANNOT BE SUSTAINED; AND THE SUCCESS OF ENLARGEMENT WOULD BE JEOPARDIZED. GROWTH, HE CONTINUED, REQUIRES MASSIVE REFORMS IN ECONOMIC POLICIES AND DELIVERY MODES. ALSO NECESSARY ARE INCENTIVES FOR IMPROVED ECONOMIC PERFORMANCE AND PENALTIES WHEN DEFICIT TARGETS ARE NOT MET. IN ITS REPORT, THE STUDY GROUP OFFERS SIX RECOMMENDATIONS FOR INCREASING GROWTH AND JOBS. WE WANT TO REPLICATE THE U.S. EXPERIENCE IN TERMS OF GROWTH, BUT ALSO CREATE JOBS, SAPIR REMARKED.

#### RECOMMENDATIONS FOR THE FUTURE

3. THE GROUP MADE THE FOLLOWING RECOMMENDATIONS:  
-- MAKE THE SINGLE MARKET MORE COMPETITIVE AND DYNAMIC;  
-- BOOST INVESTMENT IN KNOWLEDGE I.E., BOTH BY  
OTH BY  
INCREASING SPENDING ON RESEARCH FROM AN AVERAGE OF 1.9 PERCENT TO 3 PERCENT, AND ALSO ON HIGHER EDUCATION;  
-- IMPROVE THE EUS MACROECONOMIC POLICY FRAMEWORK;  
-- REDIRECT STRUCTURAL FUNDS TO LOW-INCOME COUNTRIES, RATHER THAN TO LOW-INCOME REGIONS;  
-- ADOPT MORE EFFECTIVE DECISION MAKING AND REGULATION;  
AND  
-- DIVIDE THE EU BUDGET INTO THREE FUNDS: A GROWTH FUND, A CONVERGENCE FUND, AND A RESTRUCTURING FUND.

FOLLOWING THE AUTHORS PRESENTATION OF THEIR REPORT, PANELISTS, INCLUDING THE GOI REPRESENTATIVE, ITALIAN FINANCE MINISTRY DIRECTOR GENERAL LORENZO BINI SMAGHI, (WHO IS ALSO ITALYS FINANCIAL SHERPA), RESPONDED.

#### THE OBJECTIONS

4. BINI SMAGHI CHALLENGED A KEY RECOMMENDATION OF THE REPORT THAT THERE SHOULD BE A MORE FLEXIBLE STABILITY AND GROWTH PACT, ESPECIALLY IN TERMS OF DEFICIT TARGETS OF 3 PERCENT. HE CONTENDED THAT EASING UP ON THE 3 PERCENT TARGET WOULD BE ILL-ADVISED WHEN EURO-ZONE GDP GROWTH IS HOVERING AROUND 0.5 PERCENT. DISCIPLINE IS IS  
NEEDED MOST WHEN GROWTH IS STAGNANT, HE STATED. IN A NEAR-SARDONIC TONE, HE STATED THAT THIS RECOMMENDATION SEEMED TO HAVE BEEN MADE TO PLEASE THOSE GOVERNMENTS THAT STRONGLY SUPPORT AN EASING OF RIGID STABILITY PACT RULES.

5. AT THE SAME TIME, AND IN SOMEWHAT OF A CONTRADICTION, BINI SMAGHI ARGUED THAT THE 3 PERCENT DEFICIT TARGET MIGHT BE THE WRONG GOAL. IF THE MAASTRICHT CRITERIA WERE ESTABLISHED TODAY INSTEAD OF IN THE EARLY NINETIES, THE DEFICIT TARGET WOULD HAVE BEEN LESS THAN THREE PERCENT, HE STATED. REGARDING THE OVERALL TOTAL DEBT/GDP TARGET, BINI SMAGHI CONTENDED THAT EVEN THOUGH ITALY AND BELGIUM HAVE A HIGH DEBT/GDP RATIO, BOTH COUNTRIES SURPRISINGLY HAVE THE HIGHEST LEVEL OF SUSTAINABILITY THAT IS, SERVICING THE DEBT PRESENTS NO PROBLEM, HE CLAIMED. HE MENTIONED THAT IF THE MAASTRICHT TARGETS WERE EVER TO BE RECONSIDERED, THE FOCUS SHOULD BE ON THE SUSTAINABILITY OF THE DEBT ITSELF, RATHER THAN THE DEBT/GDP RATIO.

6. THE REPORTS RECOMMENDATIONS TO GIVE STRUCTURAL FUNDS TO LOW-INCOME COUNTRIES RATHER THAN LOW-INCOME REGIONS

RAISED BINI SMAGHIS CONSTERNATION. NOT SURPRISINGLY, HE

ROME 00004651 002 OF 002

GOVERNMENTS. BINI SMAGHI ALSO OBJECTED TO THE RECOMMENDATION OF REMOVING FUNDS MANAGEMENT FROM THE COMMISSION AND GIVING RESPONSIBILITY TO NATIONAL GOVERNMENTS. HE ARGUED THAT DESPITE THE SUCCESS THE GOVERNMENTS OF IRELAND, SPAIN AND PORTUGAL DEMONSTRATED IN INVESTING STRUCTURAL FUNDS ALLOCATED TO THEM, NATIONAL COMPETENCE SHOULD NOT BE CONSIDERED A MODEL FOR THE FUTURE.

17. COMMENT: ITALIAN POLITICIANS HAVE BEEN CONCERNED THAT WITH ENLARGEMENT, ITALYS SOUTH WILL LOSE OUT ON ITS SHARE OF STRUCTURAL FUNDS. UNDER THE 2000-2004 EU SPENDING PROGRAM, SOUTHERN ITALY HAS BEEN ELIGIBLE TO RECEIVE APPROXIMATELY 25 BILLION EUROS FOR DEVELOPMENT OF INFRASTRUCTURE, COMMUNICATIONS AND HUMAN RESOURCES, AND A WIDE RANGE OF REGIONAL AND MUNICIPAL PROJECTS. BY THE  
E  
END OF 2002, HOWEVER, A MERE 8 PERCENT OF THESE FUNDS HAS BEEN APPROVED FOR DISBURSEMENT BY THE EU. PROBLEMS INCLUDE RED TAPE, POORLY IDENTIFIED PROJECTS, LACK OF SKILLED PERSONNEL IN REGIONAL GOVERNMENTS AND IN SOME CASES, CORRUPTION. END COMMENT.

18. BINI SMAGHI ALSO CRITICIZED THE REPORTS AUTHORS FOR THEIR FAILURE TO DISCUSS THE EFFECTS OF AN AGING POPULATION ON THE PENSION AND HEALTH SYSTEMS AND FOR FAILURE TO PROVIDE SPECIFIC RECOMMENDATIONS FOR PENSION REFORMS. ITALY SPENDS NEARLY 15 PERCENT OF ITS GDP ON PENSIONS, HE SAID, AND HIGH PENSION EXPENDITURES LIMIT THE POTENTIAL FOR ECONOMIC GROWTH. AN EURO-WIDE APPROACH TO PENSION REFORM IS NEEDED TO HELP BRING COSTS DOWN, HE CONCLUDED.

19. THE REPORTS AUTHORS CALLED ON THE COMMISSION TO INCREASE BUDGETARY OVERSIGHT. BINI SMAGHI CONCURRED, BUT ALSO URGED MORE EFFECTIVE USE OF THE EXISTING EARLY WARNING PROCEDURE FOR COUNTRIES FAILING TO MEET DEFICIT TARGETS.

110. IN HIS CONCLUDING REMARKS, BINI SMAGHI SPOKE ABOUT OUT  
THE POTENTIAL IMPACT OF THE SWEDISH VOTE AGAINST THE EURO. HE ARGUED THAT THE LEGITIMACY OF THE EURO CURRENCY ITSELF WAS CHALLENGED BY THE REFERENDUMS RESULTS. HOW CAN GOVERNMENTS DEFEND THE EURO AS A EUROPEAN CURRENCY IF IT IS NOT EMBRACED BY ALL, HE ASKED.

COMMENT  
-----

11. PRIOR TO ITALYS EU PRESIDENCY, FINANCE MINISTRY OFFICIALS EXPRESSED GREAT FRUSTRATION WITH THE STABILITY AND GROWTH PACT. WHILE ITALY HOLDS THE PRESIDENCY, HOWEVER, FINANCE MINISTER TREMONTI AND HIS TEAM HAVE FELT OBLIGED TO DEFEND THE PACT. NOT SURPRISINGLY, THEN, BINI SMAGHIS STRONG DEFENSE OF THE STABILITY AND GROWTH PACT DEFICIT TARGET MIRRORS WHAT WE HAVE BEEN HEARING LATELY FROM TREMONTI. COME JANUARY, HOWEVER, THE STORY MAY WELL BE DIFFERENT, ESPECIALLY UNDER THE LIKELY SCENARIO THAT ITALY ITSELF WILL STRUGGLE TO MEET THE 3 PERCENT DEFICIT TARGET IN 2004. (COMMENT: ITALYS 2004 DRAFT BUDGET PREDICTS A DEFICIT OF 2.2 PERCENT. NONETHELESS, WE BELIEVE THIS IS AN OVERLY OPTIMISTIC GIVEN THE BUDGETS  
ETQS  
LIMITED SPENDING CUTS. BUDGET TO BE REPORTED SEPTTEL. END COMMENT.)

112. SURPRISINGLY, BINI SMAGHI DID NOT PICK UP ON THE MAIN THEME OF THE REPORT: THE ACUTE NEED FOR ECONOMIC GROWTH. HE OFFERED NO ALTERNATIVES TO THE GROUPS RECOMMENDATIONS, AN ESPECIALLY GLARING OMISSION SINCE ITALY HAS ONE OF THE SLOWEST GDP GROWTH RATES IN EUROPE. END COMMENT.

NNNN  
2003ROME04651 - Classification: UNCLASSIFIED